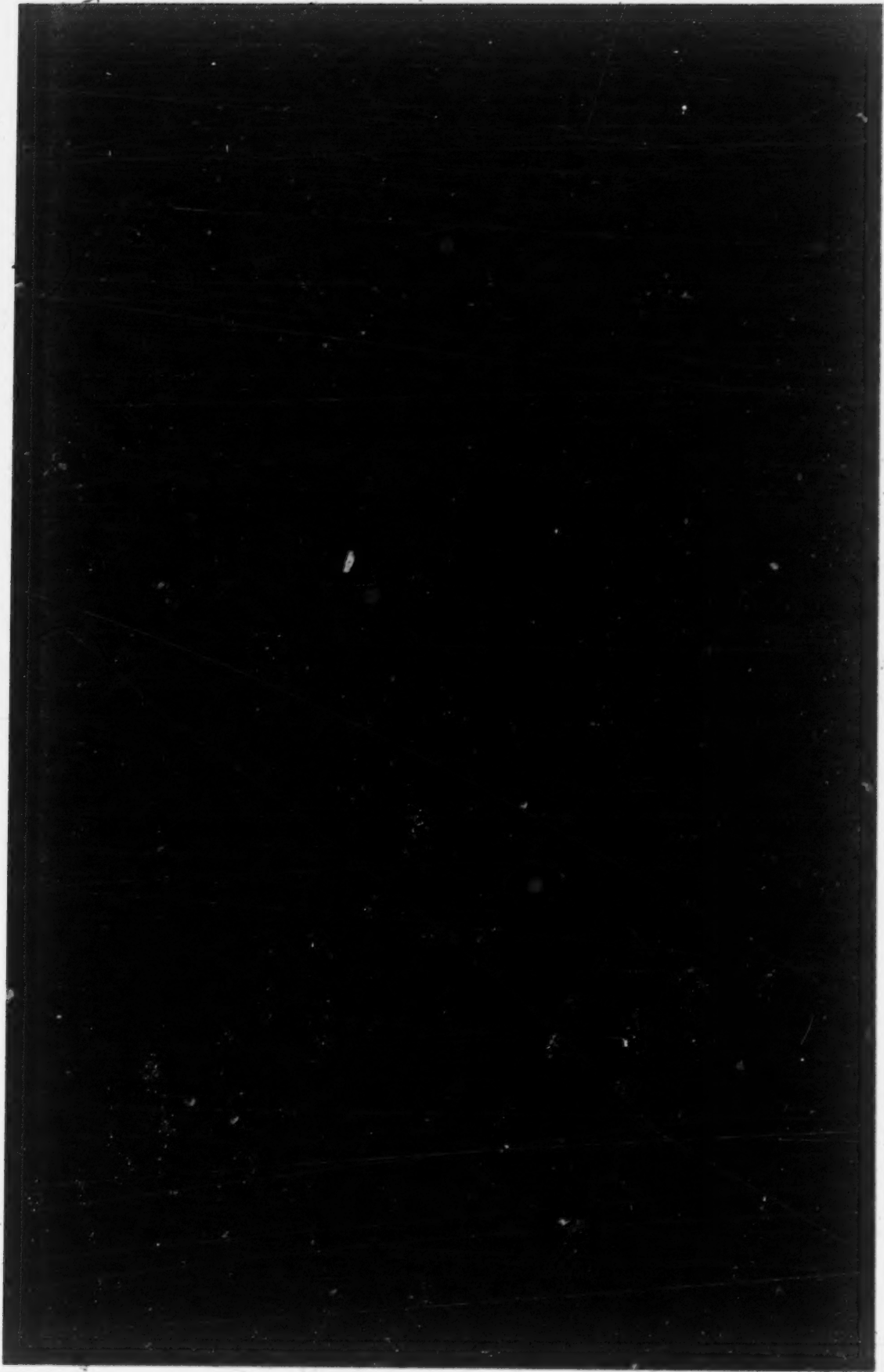


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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

HARRY A. KAPLAN

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims in favor of the plaintiff below for the sum of \$2,084.20, with interest, entered under date of April 26, 1937.

OPINION BELOW

The special findings of fact, conclusions of law, and opinion of the Court of Claims are reported in 18 F. Supp. 965.

JURISDICTION

The judgment of the Court of Claims was entered April 26, 1937. A motion for a new trial was filed by the United States on June 24,

1937, and was denied by the Court on October 4, 1937. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

The only question presented is whether the taxpayer, who sold certain securities at a profit during his taxable year 1929 and reported the entire profit therefrom in his 1929 income tax return in accordance with his method of keeping his books, can later recover the tax paid for 1929 by treating the sale as an installment sale taxable in accordance with the provisions of Section 44 (b) of the Revenue Act of 1928.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations involved in this case are printed in the Appendix, *infra*, pp. 9-14.

STATEMENT

The Court of Claims made the following special findings of fact:

1. A joint income-tax return of plaintiff, Harry A. Kaplan, and his wife, Ethel, for the year 1929 was filed March 15, 1930, indicating a total tax of \$2,084.20 which was paid—\$584.20 on March 17, 1930, and the balance of \$1,500 in the amount of \$500 each on June 13 and October 16, 1930, and \$500 on July 23, 1931. For 1929 and all subsequent years plaintiff kept his books of ac-

count and made his Federal-tax returns on the cash receipts and disbursements basis.

Included in gross income in the return was an amount of \$194,000, being the difference between a net selling price of \$240,000 and a purchase price of \$46,000 paid in June 1928 for shares of stock in "1100 Park Avenue" which Harry A. Kaplan, April 11, 1929, agreed to sell under a contract whereby the purchaser was to pay \$250,000, as follows: \$25,000 down and \$225,000 in monthly installments of \$1,875 beginning October 1, 1929, together with interest, the shares in the meantime to be deposited in escrow. The plaintiff in 1929 paid \$10,000 commission on the transaction, making the net selling price to him \$240,000. On December 28, 1929, plaintiff agreed to an assignment made September 23, 1929, by the purchaser of his obligations under the contract to a third party, the Comas Holding Corporation.

During 1929 plaintiff received from the purchaser or his assignee \$30,625 on the sales contract; in 1930 he received \$22,500 in monthly installments of \$1,875; and in the first three months of 1931, \$5,601.51, after which time the agreed payments ceased. By agreement of August 12, 1931, between Ethel Kaplan, to whom plaintiff had assigned his interest in the contract for a nominal consideration, and the Comas Holding Corporation, the balance of \$191,273.49 was to be paid \$2,273.49 down and \$2,000 monthly beginning September 1, 1931. In 1931 there was paid to plaintiff on the

revised agreement \$6,273.49 to the end of October, at which time payments again ceased. A further agreement was entered into March 19, 1932, between Ethel Kaplan and the Samuel Silver Realty Co., Inc., whereby the former agreed to sell the same shares of stock to the latter for \$75,000, payable \$750 down and the balance in monthly installments of \$750 beginning April 10, 1932.

2. Plaintiff filed a joint income-tax return for himself and wife for 1930 on March 16, 1930, showing no taxable income and no sale of stock in "1100 Park Avenue" or profit or loss thereon. Plaintiff filed no income-tax returns either for 1931 or 1932.

3. Internal Revenue Agent in Charge, R. T. Miles, New York City, notified plaintiff by letter November 18, 1931, of his decision, after audit and investigation of the 1929 return, to recommend an overassessment of \$2,084.20 for 1919,¹ conceding plaintiff's right to compute the tax on the sale here involved on the installment basis.

February 29, 1932, the Commissioner of Internal Revenue notified plaintiff of his disapproval of the internal revenue agent's report and stated that no overassessment was disclosed.

4. March 12, 1932, plaintiff filed a claim for the refund of \$2,084.20 for 1920² on the

¹ The record shows this date to be 1919, but it should be 1929.

² The record shows this date to be 1920, but it should be 1929.

ground that he was lawfully entitled to report the stocks-sale transaction on the installment basis. The Commissioner of Internal Revenue rejected this claim January 23, 1933.

On the basis of the foregoing special findings of fact the court concluded as a matter of law that the taxpayer was entitled to recover the amount of income tax originally paid for the year 1929, and entered judgment accordingly.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that Section 44 (b) of the Revenue Act of 1928 governs in determining the amount taxable to the taxpayer for the year involved as profit derived from the sale of certain securities.

2. In holding that the taxpayer erroneously and mistakenly reported in his income tax return for the year of sale the full amount of profit derived from the sale of certain securities.

3. In holding that the method or basis adopted by the taxpayer for reporting his taxable income for the year involved did not clearly reflect his income.

4. In holding that the taxpayer's action in reporting in his income tax return for the year of sale the full amount of profit derived from the sale of certain securities did not constitute a binding election to have his profit taxed on that basis and did not preclude him from later having his

profit taxed under the provisions of Section 44 (b) of the Revenue Act of 1928.

5. In its conclusion of law, based upon its special findings of fact, that the taxpayer is entitled to recover the sum of \$2,084.20, with interest, as provided by law.

6. In rendering judgment for the taxpayer for the sum of \$2,084.20, with interest, and in failing to enter judgment for the United States dismissing the taxpayer's petition.

REASONS FOR GRANTING THE WRIT

In holding that the taxpayer is entitled to recover from the United States under the facts of this case the court below decided questions of law in such manner that its decision is in conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in *Pacific Nat. Co. v. Welch*, 91 F. (2d) 590. In that case it was found that the taxpayer purchased certain real property in 1927 which was thereupon transferred to a trustee, the taxpayer becoming the sole beneficiary. During 1927 the property was subdivided for sale, and lots were subsequently sold under circumstances which would have permitted the taxpayer to report its gains on the installment basis in accordance with the provisions of Section 44 of the Revenue Act of 1928. Instead, however, the taxpayer treated the sales as deferred payment sales (the obligations of purchasers being treated as having a fair market value equivalent to their face value) and reported

its gains from sales of lots in accordance with its method of keeping its accounts.

The Circuit Court of Appeals for the Ninth Circuit held that the method of accounting used by the Pacific National Company clearly reflected its income, that the company had properly reported its income in accordance with its method of accounting, and that having reported the profit from sales on the basis elected in making its return, the taxpayer was precluded from later claiming a refund for the year involved by having the profit from sales computed on the installment basis in accordance with the provisions of Section 44 of the Revenue Act of 1928.

The Pacific National Company filed a petition for certiorari, No. 528, present Term, which was granted on December 6, 1937. It based its petition upon an asserted conflict with the decision of the Court of Claims in the instant case and the decision of the Circuit Court of Appeals for the Fifth Circuit in *Morrow, Becker & Ewing, Inc. v. Commissioner*, 57 F. (2d) 1. In the brief in opposition filed in that case on behalf of the Collector of Internal Revenue the distinction between the *Pacific Nat. Co.* case and *Morrow, Becker & Ewing v. Commissioner*, *supra*, was pointed out at page 12. It was also suggested that while we believe the decision below in the instant case to be erroneous, the case could probably be distinguished in the light of the opinion of the Court of Claims in *Le Bolt & Co. v. United States*, 67 C. Cls. 422.

This Court granted a writ of certiorari in *Pacific Nat. Co. v. Welch*, *supra*, on December 6, 1937, presumably in the belief that there is a probable conflict between the decision of the Circuit Court of Appeals for the Ninth Circuit and the decision of the court below in the instant case. Since the facts found and the questions of law involved in the two cases are so similar, a writ of certiorari should also be granted to review the decision of the Court of Claims in the instant case.

Respectfully submitted,

STANLEY REED,
Solicitor General.

JANUARY 1938.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

PART II—COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

“Net income” means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but

if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in

that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding \$1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) *Change from accrual to installment basis.*—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

SUPPLEMENT B—COMPUTATION OF NET INCOME

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of

property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(c) *Amount realized*.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss*.—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) *Installment sales*.—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule*.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913*.—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

Treasury Regulations 74:

ART. 321. *Computation of net income*.—Net income must be computed with respect

to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331-333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. * * *

ART. 331. *When included in gross income.*—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the ap-

proved method of accounting followed by him. * * *

ART. 351. *Sale of personal property on installment plan.*—

* * * * *

In the case of a casual sale or other casual disposition of personal property other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, for a price exceeding \$1,000, income may be returned on the installment basis provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition is made do not exceed 40 per cent of the selling price.

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper allowance for damage and use, if any, will be income of the vendor for the year in which the property is repossessed, and the property repossessed must be carried on the books of the vendor at its original cost, less proper allowance for damage and use, if any.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible.

If an installment obligation is satisfied, or otherwise disposed of, gain or loss may result therefrom and must be determined in accordance with section 44 (d) and article 355.

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